

Pragati

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To be free

SPECIAL ISSUE



ON THE SEPARATION OF POWERS
FROM GAY RIGHTS TO PROPERTY RIGHTS
FUNDING THE HAJ
LABOUR, CAPITAL AND THE LAW
A RUB ON THE WRONG SIDE OF FAITH

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CONSTITUTIONALISM

In defence of liberty

To think, talk and trade without interference

SHRUTI RAJAGOPALAN

"If we wish to preserve a free society, it is essential that we recognize that the desirability of a particular object is not sufficient justification for the use of coercion." Friedrich August von Hayek

IN THE process of conceptualising this issue of *Pragati*, I asked the contributors to discuss "how the laws, their enforcement and the judiciary affecting can be reformed in India." In my effort, I revisited the Constitution to understand the rules of the game and how it affects human action in areas of life as diverse as financial regulation and sexual freedom, and realised that Ludwig von Mises got it right when he said that "the idea that political freedom can be preserved in the absence of economic freedom, and vice versa, is an illusion. Political freedom is the corollary of economic freedom."

The fundamental criterion for preserving individual freedom within a state is a constitutional democracy. After all there is no difference between the absolute power of an autocrat and the absolute power of a democratic state. The difference arises only when there are limits to this kind of power imposed by a constitution. While it may seem contradictory at first thought, but the Con-

stitution is the most undemocratic document. It poses strict limits on what a representative legislature can and cannot do. The most important part of a constitution consists of "negative rights" which imposes restrictions on the state to interfere with an individual's life, liberty and pursuit of happiness.

In India however, we haven't been so lucky and are stuck somewhere between the unlimited power of a democratic state and a constitutional democracy. This is because the limits imposed by the covenant that India's founding fathers conceived have been deleted, diluted and disregarded at every opportunity. One may be tempted to ask why is this important to anyone other than a lawyer and judges? The Constitution lays down the rules of the game for each player. And every Indian citizen has been cheated in the game because the opposing side keeps changing the rules for its benefit.

This is been done for various reasons. Some rules are changed because of a specific cause such as equity or social justice, others to preserve a specific social or moral goal, and yet others to protect individuals from their own folly, and most often for the private benefit of the powers that be.

The aim of this issue is to discuss how these rules affect incentives and thus influence human action.

The most fundamental of all is the right to private property. What does this right really mean? The right to private property essentially creates a sphere in which the individual is free of the state. So while it begins with the ownership of capital without interference, it also means the ownership of one's bodily integrity and the fruits of one's labour. The abridgement of this right in India was originally to take land from the *zamindars* and has extended to taking land from poor farmers, nationalising banks and businesses, preventing the use of one's property without interference and has stretched into the realm of political freedoms such as the right to expression through a work of art or to publish a book.

Individual rights and freedoms—which have conventionally been classified as “economic rights and freedoms” or “political and social rights and freedoms”—are uni-dimensional labels. This be-

The limits on the legislature imposed by the covenant that India's founding fathers conceived have been deleted, diluted and disregarded at every opportunity.

comes more clear as the various themes in this issue are explored.

TCA Anant discusses the role of the judiciary in preserving these property rights and charts the change in this role from a conservative to an activist judiciary. He discusses the role of separation of powers, where each function of the state is performed by a different institutional entity, in preserving a limited constitutional democracy and the economic rationale for such a system of separation of powers and checks and balances. He sheds light on how the role of the judiciary as the protector of individual freedoms has now metamorphosed into an activist judiciary which can be as arbitrary as the other wings of the government. Most importantly, it becomes clear that men can be arbitrary in a position of power whether they legislate from a parliament or rule from the bench.

On the one hand, Barun Mitra uses the right to private property, conventionally an economic right, to defend the right to freedom of expression of homosexuals, and to analyse the recent Delhi High Court judgement de-criminalising unnatural

intercourse. A similar case can be made to defend MF Husain's right to paint, book publishers' right to publish *Satanic Verses* and Salil Tripathi's right to comment on free speech in his latest book *Offence-The Hindu Case*, which is reviewed in the books section.

On the other hand Atanu Dey discusses the right to religious freedom, conventionally a socio-political right, and the separation of the church and state to expose the economic tyranny brought about by arbitrary and discretionary taxes and religious subsidies. An economist would tell you that subsidies are justified for the provision of a public good or when the provisioning is sub-optimal. Mr Dey exposes how the Haj subsidy does neither and is an arbitrary use of power by politicians to gain votes subverting one constitutional pillar of the separation of church and state in the name of another value of religious freedom. Such arbitrary laws only invite more of the same and politicians are now advocating that poor Hindu and Christian groups get similar subsidies for their pilgrimages. This analysis has been extended to the functioning of industries in the markets by Harsh Gupta in his critique of India's competition and antitrust policy. While the abolition of the Monopolies and Restrictive Trade Practices Act is a welcome institutional change, the new Competition Commission suffers from the same fundamental problem of arbitrariness in its rulings, penalising firms for charging a high price as well as a low price, subverting rule of law.

While constitutional rights and liberties determine the limits on how much the state can interfere in the sphere of individual action, there is a host of laws and regulations which interferes with the economic actions of almost every Indian. The adage that the road to hell is paved with good intentions is fitting for most Indian regulation. Indian laws and regulations often try to fight economic freedom and market forces to protect individuals. However, these have unintended and often disastrous consequences. The first and perhaps the most pervasive of these are labour laws. Jaivir Singh analyses how these well-intentioned labour laws protect a small proportion of the formal labour force while marginalising a majority of the workforce in the "unorganised sector". Mr Singh explains how these paternalistic laws, created to protect the worker, often deprive her of the choice between work conditions and higher income or the ability to work in a legitimised status.

The plight of the labour force is also shared by the capitalist due to the myriad of regulation on entrepreneurs. Aadisht emphasises the need for industrial liberalisation along with market liber-

alisation to allow the entrepreneur to unleash prosperity. The current regime only fosters corruption and preserves special interests and hurts the small businessman it sought to protect.

How changing the rules changes the behaviour of the players can best be seen at work in Ajay Shah's analysis of financial regulation and environment. Repealing the archaic law controlling capital issues and legislating to set up the stock market regulator changed the institutional structure of the financial markets, in particular making the equity market take off. An excellent juxtaposition is offered with the banking sector which is still shackled in an old institutional framework. If the magic of changing the institutional structure is to be believed, there is a strong case for creating such institutional changes in other sectors.

K Satyanarayan calls for similar institutional reforms in the education sectors to make schools flourish like equity markets. He suggests that allowing for-profit educational institutions will do the trick.

The purpose of the issue is not to just to catalogue the various areas that need reform, but also to highlight many ways in which the state infringes on individuals using the legislative and judicial machinery at its disposal. Mises said that "freedom is indivisible. As soon as one starts to restrict it, one enters upon a decline on which it is difficult to stop." This has become the reality of the Indian social, political and economic spectrum where no means are left unused to abridge the rights of individuals and their ability to make decisions. This issue is in defence of our right to think, talk and trade without interference. It is in defence of our liberty.

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JUDICIARY & ECONOMIC POLICY

From conservative to activist

Understanding the dynamics of the separation of powers

TCA ANANT

THE INTERFACE between law and economic policy in India is a fascinating exploration of the issues relating to constitutional doctrines of separation of powers and issues in development policy. The role played by the judiciary takes us into domains of policy and governance that is unique in the democratic world.

This story has a number of phases. The first phase began with Independence and continued until the mid seventies. During this phase the court may be described as being conservative but essentially protective of the constitutional rights. It avoided confronting Parliament on issues of economic regulation and civil liberties, preferring to help establish the legitimacy of the central government. However, its inherent legal conservatism led it to conflicts with the executive and legislature on laws related to property. The right to property was originally included among the Fundamental Rights. It was this right that was seen by successive Congress Party governments as the most serious obstacle to socialism or social reform

and the effort to break the power of traditional elites. The Forty-Fourth Amendment to the Indian Constitution represents the culmination of this process. Apart from removing the right to property as a fundamental right and locating it as a much weaker statutory or constitutional right, where it reads as "No person shall be deprived of his property save by authority of law", this amendment constitutionally precludes judicial questioning of any compensation regime put in place by the legislature.

The next phase was brief, with the Emergency, and the suppression of basic rights. The end of the Emergency in 1977, sees the emergence of the court in a new interventionist light. This happened with the Supreme Court enlarging the reach of law and its jurisdiction in two ways. One, by re-interpreting the Constitution to expand the scope and content of various Fundamental Rights, and two, by moderating the ancient requirement of *locus standi* (standing and interest) for access to judicial remedies and redress. As a consequence,

where it was felt that there had been gross violation of Fundamental Rights, procedural requirements were eased to enable individuals or organisations to approach the Supreme Court and High Courts on the behalf of those unable to do so themselves, "in the public interest." Typically these cases dealt with gross violation of rights—many of them involving women as victims, in locations such as prisons and remand homes.

Activism

However it was the Bhopal Gas Tragedy that changed the character of this intervention. The legal response to Bhopal was poor, and the matter was settled leaving no opportunity to develop a jurisprudence on mass torts. However the incident both raised public concern as well as highlighted the failure of the existing legal regulatory framework for taking remedial steps. This then laid the ground for a number of public interest

solutions were adopted (for instance, on forests, the right to food and Delhi Master Plan.) A second form of judicial intervention took place where the courts felt that the existing legal regime was not adequately protective of rights. Thus in the now famous Vishaka judgement, aggravated by the fact that civil and penal law in India does not protect women from sexual harassment in the work place, the Supreme Court specified a model law to prevent sexual harassment.

The benefits and achievements of this expanded role for the judiciary are undeniable, but then what are the costs?

Separation of powers: an economic rationale

The concept of transaction costs could be used to develop an economic rationale for describing the institutions comprising the State. The basic idea is that if no transaction costs are incurred towards establishing and maintaining the order that the State aspires towards, the institutional form of the State would not matter. The question then arises, what exactly are the types of transactions costs that different institutional mechanisms in the State seeking to mitigate?

The legislature in modern democracies is constituted through elected representatives, which implies that the representatives encapsulate in their own preferences an aggregate measure of those who elect them, enabling them to make decisions relating to provision of public goods and creation or abrogation of rights. These decisions require making distributional assumptions on the preferences of the affected population.

Similarly judiciaries adjudicate competing claims of parties with private information and vested interests in their disclosure through adoption of rules of procedure and decision making which are efficient and perceived to be *ex ante* fair under such situations of incomplete and asymmetric information.

Finally the executive can be viewed as a hierarchical body that makes technical decisions in the face of incomplete information by creating systems of incentives and structure that allow the use of scientific, epidemiological and statistical knowledge and personalised idiosyncratic skills.

The significant inference could be that since the legislature, the executive, and the judiciary process uniquely distinct categories of information, the separation of powers doctrine acts to minimise transaction costs. It follows from this that allocation problems themselves should be paired up with the appropriate institution to gain an efficient solution.

The formulation spelled out is schematic in

The vehicle of executive action through judicial support has sought to compensate for the fact that executive decision-making was being subordinated to political expediency.

litigations (PILs) that were filed on various environmental matters. One of the most influential PILs in this category was the one on air pollution in Delhi .

In 1985, concerned with Delhi's growing pollution problems, MC Mehta filed a writ petition to direct the Delhi government to implement the Air Act. This petition led to a series of inquiries by the court on how this problem was being handled. In the early stages of the litigation, the impact was primarily to push the executive into formulating measures for pollution control. These measures were ineffective due to poor implementation. The poor progress prompted the Court into pushing the administration into creating an authority (The Bhure Lal Committee) to monitor progress and implementation. This authority was further assisted by the court in that a number of its decisions (using the tool of continuing mandamus) were made into court orders so that violation or non-implementation of the order opened the door for a charge of contempt of court.

This method of intervention was not unique and in number of cases before the courts similar

nature—in practice there can be considerable overlap across different institutions of the kind of transaction cost they minimise. It must also be realised that transaction costs in themselves are not static, often changing with technological change.

It is also essential not to misinterpret this formulation as saying that transaction costs can explain or justify the doctrine of separation of powers. To take such a stance, it would require us to show how the presence of transaction costs leads to the separation of powers. Instead we have used the notion of transactions costs, or more specifically the information costs of social decision-making, to deduce that problems confronting the State can be best solved by being placed in the appropriate niche carved out by the doctrine of separation of powers.

While these arguments are persuasive they do not account for the possibility of institutional failure. Economists are familiar with this concept and concepts relating to external economies and diseconomies and public goods have all been used to develop the ideas of market failure. The traditional textbook treatment of this issue will then argue that there is a case for a non-market institution to step in. In a similar vein we can argue that corruption, electoral infirmities and imperfect access to capital markets could affect each one of the institutions of the state. Further the dynamic character of transactions costs implies that the boundaries of decision making of these different institutions themselves cannot be rigid.

The framers of the Indian Constitution did not formulate a strict doctrine of separation of powers but envisaged a system of checks and balances. Thus the vehicle of executive action through judicial support has sought to compensate for the fact that executive decision-making was being subordinated to political expediency. This solution is fraught with its own risks of legitimacy and effectiveness. For instance, the vehicle pollution case has focused on Delhi and a few major metros. However air pollution and other forms of pollution are issues of nation-wide concern, and thus effective policy requires involvement of agents at much broader levels than are currently feasible in court procedures.

Discomfort with these solutions can be seen in a variety of court judgements where the court has cautioned on the tendency of judiciaries to encroach on legislative and executive powers. Thus in the Aravali Golf Club case the court observed “Under our Constitution, the Legislature, Executive and Judiciary all have their own broad spheres of operation. Ordinarily it is not proper



Photo: ODI

for any of these three organs of the State to encroach upon the domain of another, otherwise the delicate balance in the Constitution will be upset, and there will be a reaction.”

But the balance cannot be attained merely by a return by the court to an earlier era of conservative interpretation. In *Pareen Swarup* (2008), the Court observed that “[it] is necessary that the Court may draw a line which the executive may not cross in their misguided desire to take over bit by bit and judicial functions and powers of the State exercised by the duly constituted Courts. While creating new avenue of judicial forums, it is the duty of the Government to see that they are not in breach of basic constitutional scheme of separation of powers and independence of the judicial function.” Or, in the matter relating the Madras High Court decision on the Madras Bar association case the Supreme Court pointed to the need for a constitution bench to examine the domain of legislative competence in creating new judicial forums.

Appreciating the correct role for each constitutional institution is a challenge which we need to take up in order to develop a more sustainable model of governance. Similar words could be used for the activist Indian Judiciary.

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Photo: Vinayak Das

RIGHTS

Recognising diversity and dissent

The significance of decriminalising Section 377 of the penal code

BARUN MITRA

THE DELHI High Court's ruling decriminalising consensual adult homosexual acts has not only enabled gays to come out of the closet, but has also revealed many other strange bedfellows. Many leaders of different religions—Christians, Hindus, Muslims—find themselves united in expressing their disapproval. Many others, who normally prefer to wear their secular credentials on their sleeves, seem to have suddenly discovered their affinity for tradition and culture and have come out strongly against this judgement, others seem to have discovered that ambiguity and silence are the better parts of valour. The communists, hardly the epitome of tolerance, seem to be the only group among the political class to have welcomed this verdict.

The opposition from the conservatives and the ambiguity among the "secular" political class stems from a failure to distinguish between ethical values and legal implications of this judgement. While laws need to stem from moral values, moral values do not necessarily become laws. Not everything that one disagrees with needs to be made illegal. One way to look at this is that while

the law provides the floor, the basic framework for individual behaviour in a society, moral values represent the high ceiling, which one should aspire to, but which is well beyond the legal norm. Just as we may endorse the right of smokers or drinkers to pursue the freedom to exercise their choices without endorsing many of those behaviours, everyone can endorse the right of homosexuals to pursue their lifestyles, regardless of whether they approve or disapprove of homosexuality.

In that context, the Delhi High Court's ruling to decriminalise homosexual behaviour among consenting adults is a very welcome and long awaited step forward. We human beings have the right to make choices—that is what makes us human.

The judgement says, "Respect for human rights requires that certain basic rights of individuals should not be capable in any circumstances of being overridden by the majority, even if they think that the public interest so requires. Other rights should be capable of being overridden only in very restricted circumstances. These

are rights which belong to individuals simply by virtue of their humanity, independently of any utilitarian calculation." This is a lofty and noble idea, and if the Indian judiciary lives up to it, it will be an extraordinary step forward.

The judges relied on Articles 14, 15 and 21 of the Constitution to minimise the scope of section 377 of the Indian Penal Code (IPC). A logical consequence of this judgement ought to be decriminalisation of prostitution—same-sex and heterosexual. If consensual acts among adults of the same sex individuals in private, is legitimate, then there can hardly be objection to the oldest profession. That would be truly historic.

hundreds of thousands of people from their homes, all for the sake of some wider public interest. No court has ruled against the substantive validity of eminent domain so far, upholding acquisition of private property, although increasingly restrained by qualifications. Yet, there is no political authority in the country today that is keen to invoke the law, even as it stands in the statute, to acquire private land any more, increasingly aware of the rising political costs of such endeavours.

The Delhi High Court judgement profoundly notes, "The role of the judiciary is to protect the fundamental rights. A modern democracy while

The smallest minority in any society is the individual, and his rights need to be protected, so that all minorities may enjoy the same protection, and are treated as equals before the law.

It is also interesting that the judgement did not invoke Article 19(1)(a), the freedom of expression, and expand the scope of "reasonableness", although that is what the judgement has sought to do by sanctioning diverse sexual inclinations.

The socio-political question is that by making the present HC verdict as a symbol of the change, the gay community may have attracted upon themselves unnecessary attention, and now they may have to prepare to face their long dormant, but reactivated vocal critics. As society progresses through such churning, unpleasant ideas come to the fore, and one has to debate and decide to take sides, but one has to be prepared to pay the price that such churning may unfortunately demand at times.

The right to property...in contrast

The contrast between Section 377 and the right to property could not be starker. Here is a century-old law, part of which had been defunct for all practical purposes. There is hardly a case in recent decades where this section has been invoked to prosecute consenting adults exercising their choice in private. This particular section is largely irrelevant, and can easily be retired. Yet, when the section is read down by the court to achieve precisely that, a fresh debate is ignited around sexual inclinations.

On the other hand, consider the Land Acquisition Act of 1894, another vintage of the colonial era. For decades, various governments have been invoking eminent domain, routinely displacing

based on the principle of majority rule implicitly recognises the need to protect the fundamental rights of those who may dissent or deviate from the majoritarian view. It is the job of the judiciary to balance the principles ensuring that the government on the basis of number does not override fundamental rights."

This is an admirable sentiment. For democracy to endure, majorities of the day could not be allowed to degenerate into mob rule and suppress dissent. The basic feature of democratic functioning is to protect the right of the minority to engage in the debate, and to recognise the prospect that today's minority opinion may become the majority view of tomorrow if it can peacefully persuade more people.

But how has the judiciary fared amidst constant onslaught on the fundamental right to property? This right is the foundation of all human rights, and there is hardly any right that can manifest without the right to property. The right that the gay community claims is fundamentally a right to use their own body, their most fundamental property, in the way of their own choosing—the right to property, and freedom to express themselves. Why have two pieces of law have generated such diametrically opposite responses? What has changed?

In one, there is a ground-swell of popular support, in the other, there may be some voyeuristic curiosity, but not much popular support. In one, powerful governments have been brought to

knees. In the other an apparent non-issue has made the powers that be wary of disturbing the status quo. There is a very powerful political lesson in these two contrasting experiences. When the ground shifts, laws either have to reflect the new mood of the public, or become redundant. And without that change in the popular perception, even the most progressive law, may not carry the day. For all these years, the gay community had sought to bring attention to their cause by waving their flag, by standing apart, by claiming to be different. Today, they find themselves largely isolated, the support from the visible and vocal classes not amounting to much politically.

The difference is between legitimacy and legalisation. Law is not what is on the statute, but what is perceived to be just. Even in their greatest victory till date, the gay community in India is unfortunately as far from gaining that legitimacy as ever.

The gay community, just like any other minority, need to move away from their sense of collective identity as gay, nor flaunt their sense of victimhood. Framing the issue as collective rights invariably leads to pitting one collective against

the other, and in such conflict it is not easy to overturn the collective that claims to represent the majority. But the smallest minority in any society is the individual, and his rights need to be protected, so that all minorities may enjoy the same protection, and are treated as equals before the law.

To gain that legitimacy, however, one has to discover the fundamental right, the right to property, which means to recognise and respect that right of every individual human being.

Once society begins to recognise the value of property rights, we will find that we can live together respecting each others' choices and values, even when those values apparently conflict with each other. That would be a victory which all of us would be able to celebrate. And then the law will not merely be legislation in the statue book, but also legitimate in the popular eye.

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SECULARISM

Stop subsidising pilgrimages

The Haj should be financed from private charity

ATANU DEY

IN THEORY, according to its Constitution the Indian State is secular; in practice, unfortunately, it is far from it. Indian governments routinely meddle in religious affairs and do not treat all its citizens as equal in matters of religion. They involve themselves in matters such as temple administration, fund management of temple donations, and subsidising pilgrimages. The most blatant example of such gratuitous meddling is the subsidy given to its Muslim citizens for performing the Haj to Saudi Arabia. In 2008, Indian taxpayers paid around Rs 7 billion (US\$ 140 million) for this purpose.

Is that a reasonable thing for the government of India to do? No: it is bad in principle, economically inefficient and morally wrong. The government of a secular state must not concern itself with religious matters. India would do well to consider the example of the United States.

The first item of the US Bill of Rights, authored principally by James Madison and adopted in 1791, begins with the injunction that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof . ." The absence of sectarian strife in the United States is at least in part attributable to that amendment which, in the words of James Madison establishes a wall of "total separation of the church from the state."

Something like the first amendment is vitally important and must be among the core set of rules of all civilised states. It traces its origins to the ideas of John Locke who held that each individual is free and equal, and that the job of the government of a civilised society is to protect the property rights of its citizens. The United States strictly maintains that separation, as it should since it claims to be a secular state. It contrasts sharply

with what goes on in India.

The rationale behind the Indian government's haj subsidy goes against any notion of social justice, fairness, and economic reasoning. First, religion is a purely private affair and the government of a purportedly secular state should not get into the business of promoting any religion. Subsidising the Haj is discriminatory and tantamount to endorsement of Islam. No other country on earth—including Islamic states—subsidises Haj.

Second, the subsidy is unfair. Fairness is the cornerstone of justice. It is unfair—and therefore unjust—for the government to force citizens to subsidise the Haj because ultimately it is the taxpayers' money that the government hands out.

Third, the Haj subsidy politicises a purely religious matter. Political parties attempt to woo Muslim votes by increasing the subsidy. They are in effect robbing non-Muslims to pay Muslim, thus attempting to gain the endorsement of Muslims. This is totally unconscionable.

From an economic point of view, subsidies and taxes are sometimes justified. For instance, revenues required for the provision of public goods have to be raised in some way and taxes are one way of doing so. Subsidies are justified in cases where markets fail to provide the socially optimal quantities of public goods. Even then, from an economic efficiency point of view, the taxes required for balancing the subsidies should be paid by the beneficiaries of the public good in question.

A case can even be made for the tax-funded public provisioning of some non-public goods and services, as when very high transaction costs are involved. Collective provisioning through taxes of a private good is justified when it is too expensive to determine individual quantity consumed for apportioning costs among a very large number of users.

The Haj subsidy paid for from general tax revenues cannot be justified on the economic grounds mentioned above. The Haj is not a public good; there is no market failure in its supply; the apportioning of costs is simple and efficient.

Can the Haj subsidy be justified on the grounds that it is charity? It is said that charity begins at home. And that is where it should stay. As a general principle, governments must not appropriate for itself the purely personal decision of its citizens on the matter of which charitable activity to support and to what extent. It is a matter of property rights: one has a right to spend one's income as one sees fit. Using tax money to support discretionary spending is tantamount to extortion under the threat of violence, since one can be imprisoned for refusing to pay taxes.

Finally, there is the pernicious endowment effect: once an unearned benefit is granted, it is very difficult to remove it without incurring the wrath of the beneficiaries. No government would like to run the risk of removing the subsidy and antagonising a large voting constituency.

The problem has a straightforward solution: move the funding of the Haj subsidy from the public domain to the private domain. Constitute a non-governmental body whose task is to raise funds from private citizens. It is possible to do so in this day and age of low transactions costs due to the internet and mobile telephony. When people voluntarily contribute to fund the subsidy, it moves from the realm of coercion and becomes truly charitable.

This also takes the politics out of the whole matter and reduces the temptation that politicians have in robbing one group to gain the support of

The issue of financing the Haj has a straightforward solution: move the funding of the Haj subsidy from the public domain to the private domain.

another group. By making this entirely voluntary, it removes the deep resentment many non-Muslims feel regarding the matter.

But there is a larger point which goes to the heart of what the job of a government is. Protecting the lives and property of its citizens is the primary reason for its existence. Everything else is secondary. Citizens should be on guard and prevent the government from usurping the freedoms that rightfully belong to them. When the government intrudes into such personal matters as whether or not to support the religious activities of some specific group, the state moves a little bit closer to fascism.

India needs to become a truly secular state since it is multi-religious. Its government has to be constitutionally directed to maintain a strict distinction between matters of religion and matters of state. If this requires a constitutional amendment, then it is time to introduce such a bill. The Indian government has to stop riding roughshod over the basic inalienable rights of its citizens—that of the rights to personal property and equality before the law. India needs the equivalent of the first amendment to the constitution of the United States of America.



Photo: BBC

LABOUR LAWS

Working under the law

Reforming labour laws is better than cleverly nudging its practice

JAIVIR SINGH

THE INDIAN labour force consists of about 430 million persons, three-fifths of whom are employed in agricultural activity. The rest of the force is spread over industrial and service activity. A descriptive picture of the Indian labour market can be drawn by placing the large, rural labour force at one end of a notional spectrum and locating a small, high productivity 'formal' sector labour force (forming only eight per cent of the total) at the other end. In-between is a growing residual 'urban informal' or 'unorganised' sector, typically associated with the provision of services, but more importantly, associated with low productivity employment—the ubiquitous underemployed or the disguised unemployed of a 'developing' economy.

While the formal sector is covered by labour laws, the bulk of the labour force—the agricultural as well as the informal sector workforce, is not. In other words, the many Indian labour laws (covering a wide gamut of labour welfare issues ranging from security of tenure to laws covering work conditions) are relevant only to a formal sector worker who is employed in a legally recog-

nised category of establishment where labour benefits are authorised by law. Also, not only must a worker be employed in establishments that qualify as formal but must also perform work which can judicially classify the worker as a "workman" under the Industrial Disputes Act, 1947 (IDA).

In contemporary India, the 'in progress' rhetoric of structural reform lists the prevailing labour law as a serious ongoing concern. The Economic Survey covering the period 2007-2008, calls for a review of labour laws citing "an imperative need to facilitate the growth of labour-intensive industries, especially by reviewing labour laws and labour market regulations." This statement acts to reinforce other recent Economic Surveys, prominently the 2006 Survey which points to the "sharp dichotomy" in the Indian labour market characterised by no regulation of the massive unorganised sector, while the organised sector provides "too much job security." This rhetoric shows up in a policy brief by the OECD in consultation with the Indian government—citing the facts that any recent generation of employment has been con-

centrated in small less productive enterprises, while employment in larger firms has not only been falling but that “(the) number of workers has also fallen in the manufacturing sector where the share of labour income in value-added is low compared to other countries and capital-intensity is relatively high.”

This is seen as a reflection of India’s inability to exploit “its comparative advantage as a labour-abundant economy.” To increase employment it is suggested that the “(the) level of employment protection needs to be reformed.” Apart from consolidation of central and state laws, this means removing constraints on regular employment contracts that are imposed on large companies. Constraints which are in contrast to those imposed on smaller firms or cover temporary and fixed-term contracts—“all areas where regular employment is increasing” and where the level of protection “is similar to the OECD average.” The policy brief goes on to suggest that reforms such as the “reduction in the stringency of employment protection” would “remove an important barrier to the

labour laws assisted to various degrees by ongoing executive and judicial practice.

One specific policy initiative of the Indian State in this regard is to set up Special Economic Zones (SEZ)—in imitation of China—to promote manufacture for exports by designating geographical areas where extensive infrastructure, fiscal support and appropriated land (creating many vexatious issues of compensation and displacement) are provided by the government. A particularly stated additional aim is to create employment opportunities.

Given the overall desire of the SEZ endeavour to push for labour-intensive export oriented consumer goods, the entire enterprise is probably best understood as being located at the border between the formal and informal sectors, drawing the labour force from the informal/agricultural sector. At this location, the very act of employment generates a dilemma because the instant a worker is drawn from the informal/agricultural sector and ‘employed’, she becomes eligible for all the benefits provided by law to formal sector

While popular rhetoric emphasises the perceived correspondence between labour laws and employment, a good deal of empirical work suggests that the proposition that employment in the formal sector has been constrained by labour legislation is, at best, empirically fragile.

expansion of smaller companies and would increase employment, productivity, real wages and the number of social benefit recipients, as well as facilitating the movement of labour out of agriculture to more productive areas.”

While the rhetoric quoted above emphasises the perceived correspondence between labour laws and employment, a good deal of empirical work suggests that the proposition that employment in the formal sector has been constrained by labour legislation is, at best, empirically fragile. This very fragility requires us to view Indian labour law and its possible reform using conceptual frames that are not preoccupied with *de jure* legislation (such as that which requires ‘large’ firms from seeking permission from the government before firing workers) but rather turn attention towards the actual implementation of the law by looking at judicial and executive practice.

It is becoming apparent that there is a good deal of ‘flexibility’ in the formal labour market, as employers have come to use increasing quantities of contract or casual labour, in addition to evading

workers. If this were indeed to be allowed, it would raise perceived labour costs which would presumably dampen national and international investment. If disallowed explicitly, the political rhetoric associated with the SEZ enterprise would end up being more widely challenged. Given the frontier location of the labour involved, the solution to this dilemma has been to nudge the practice of law in a manner which minimises the coverage of labour law without actually changing the law—a relatively smoothly accomplished step, given the nature of Indian labour law as well as the structure of the enabling law associated with SEZs.

Though the SEZ Act, 2005 overrides certain other laws (particularly granting fiscal benefits to firms located in a SEZ), it maintains that in relation to labour, standard labour laws are to continue to operate in the SEZs. While there is no change in the laws, under this regime the implementation of labour law is shifted from the control of the Labour Commissioner to the Development Commissioner of the SEZ, a figure who is given

substantial power over all aspects of governance of the SEZ. Furthermore, the ability of workers to organise strikes is curtailed by undertaking a general policy measure that labels economic activity within a SEZ as a ‘public utility service’, which under Indian law makes strikes in units labelled as such entirely illegal. All these factors taken together result in the fact that while the ‘speak’ says that labour laws are supposed to be operational in a SEZ, they are almost entirely absent in practice.

Many scattered studies covering SEZs all over India report a pattern—union activity is widely discouraged and absent in the zones, workers are not paid minimum wages, work very long hours to complete stringent targets, are subject to being fired without justification or compensation, denied any maternity benefits and suffer from work related illness.

Should we stop worrying about bad working conditions? Is there some reasoning or argument which can be invoked that will privilege concerns about work conditions in a free market world?

In relation to this some of the most interesting insights can be gathered from an ethnography that documents the narratives of women employed in the Madras Export Promotion Zone gathered painstakingly by Padmini Swaminathan. On the one side there are many disturbing narratives regarding hours of work, hygiene conditions at the work place, sexual harassment and ill-health as a consequence of hazardous work conditions. However, simultaneously, the informants also paint another picture of their lives—they say that since they have undertaken employment in the factory there is better food and clothing, pucca houses have been constructed, bore-wells have been dug to ease water problems, gas or kerosene has replaced wood fires. In particular Dalit informants speak of the upward social mobility that factory employment has given them.

This admixture of the negative and positive effects of such employment compels Ms Swami-

nathan to note that “the observation that wage income has enabled families to improve the quality of food consumed has to be juxtaposed against the reports of many respondents that they were unable to eat before leaving for work for want of time and also they often say there was an odour pervading the work areas leading to a loss of appetite and reduced intake of food.” It is precisely this juxtaposition that is particularly challenging—people who in the alternate are worse off in terms of wages and income voluntarily trading a higher wage for unregulated work conditions. If this has been voluntarily chosen, should we stop worrying about bad work conditions? Is there some reasoning or argument which can be invoked that will privilege concerns about work conditions in a free market world? Is the best reform of India’s restrictive labour laws, an atrophy of law, such that there is no law?

While it can be maintained society intervenes by insisting that there should be laws against hazardous work conditions on purely ethical grounds because such concerns will always remain inadequately served by the market (signalling an inevitable trade-off between the economy and fairness) some recent work puts forth more consequential arguments.

If we were to step to extend Kaushik Basu’s argument to labour standards more generally we get the following—while individual workers may voluntarily trade the higher wage that the SEZ employment offers against adverse work conditions and are thus better off than they were before, this generates an externality on labour as a group—thus laws that support labour standards look after the welfare of much larger groups of people than if there are no standards. There are, it turns out, some welfarist arguments that support the reform of labour law rather than encouraging the atrophy of all law.

Jaivir Singh is assistant professor at Jawaharlal Nehru University’s Centre for the Study of Law and Governance (CSLG). It draws from his CSLG working paper *Labour Law and Special Economic Zones in India*. The online version of this article has references and footnotes.

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FINANCE

Flying on one engine

Financial reforms are now critically about laws

AJAY SHAH

IN THE story of India's economic reforms, the revolutionary changes on the equity market stand out. In the early 1990s, the Indian stock market was opaque and riven with malpractice. It imposed substantial transactions costs upon the firms and households in the economy who were its users.

It is hard to overstate the magnitude of the change which has come about from 1993 to 2003:

- Physical share certificates have been replaced by depository settlement.
- Trading by open outcry, primarily on the Bombay Stock Exchange (BSE) floor, has been replaced by electronic trading, primarily on National Stock Exchange (NSE).
- The settlement process is flawless and trusted worldwide.
- Derivatives trading has taken off.
- Numerous international rankings in finance now have something from India in the top 10 list: this includes the number of transactions per day at NSE and BSE, the number of contracts traded of derivatives on Nifty and the number of contracts traded of individual stock derivatives. Apart from the equity market, there is nothing from Indian finance that is found in top-10 global lists.

• A new governance model has come into place, with a three-way separation between owners of the exchange, the managers of the exchange and the member firms.

• The equity market has the full food chain, from investment in start-ups and unlisted companies by venture capitalists to a screen-based initial public offering (IPO) auction to secondary market trading to individual stock derivatives to index derivatives, index funds and index exchange trading funds (ETFs). It has a rich ecosystem, with individuals, domestic institutional investors and foreign institutional investors, and without significant trading by the government or by public sector units.

It is fair to say that almost nobody in 1993 could have predicted that in a short ten years, India would achieve such far-reaching change, despite concerted political lobbying against it.

Alongside these immense changes, however, there has been a striking stasis in other parts of Indian finance. Banking in India looks much like it did in 1993. There are private banks, but their share in deposits and assets is below 10 percent. The behaviour of banks and bankers in India continues to be essentially the same as it was 20 years ago: mostly driven by a detailed rules-based system which prevents the information processing that is the essence of banking. The same is the problem with insurance or pensions, which are largely unchanged when compared with 1993 when we consider the facts on the ground, of where the assets are. Old-timers remind us that the bond market in 1990 and 1991 actually had more liquidity than what is found today; what has been achieved is actually the replacement of a

A good banking system, a good insurance industry, a strong pension system, all these are important enablers of growth. Most of all, the deeply inter-linked bond market and currency market is essential.

crisis-prone vibrant market with a perfectly safe non-market. Policy-makers have pushed a great deal of electronics into the bond market and the currency market, and in some ways it has helped reduce risk. But the end-goal of a liquid and efficient market, with vibrant speculative price discovery, has remained elusive.

India is thus hobbled without a fully functioning financial system. An economy with only one success story in finance—the stock market—is like a plane flying on one engine. For finance to play its full role in fostering high economic growth, other elements of the financial system have to come to life. A good banking system, a good insurance industry, a strong pension system, all these are important enablers of growth. Most of all, the deeply inter-linked bond market and currency market—which has been termed the ‘Bond-



Photo: Prem Anandh

Currency-Derivatives (BCD) Nexus' by the Percy Mistry report—is essential from many points of view. The bond market is required for financing public debt in a healthy manner, for financing long-dated infrastructure projects, for enhancing the growth of companies through issuing corporate bonds, and for enabling loans to households.

A certain approach towards financial sector reforms has been tried for almost 20 years now. It is important to step back and ask why the reforms of the equity market worked while the reforms of other areas of Indian finance did not. If this question is not asked, and if incremental efforts are continued for the next decade in much the same fashion as has been done for the last two decades, then there is every likelihood of trundling along for one more decade and (in the end) only having an equity market.

What went right with the equity market in the early 1990s? A few critical elements can be identified:

- New law-making created a new regulator, the Securities and Exchange Board of India (SEBI).
- Critical elements of SEBI's design were done right. SEBI does not own market infrastructure; it only regulates markets. SEBI has no view on whether prices should go up or down: it only worries about fair play on markets. It does not trade on financial markets.
- SEBI was a brand-new agency, which created a team which was culturally and intellectually oriented towards the concept of financial regulation as applied in the context of a financial market comprised of private actors. The phrase 'fostering

'speculative price discovery' was absorbed into SEBI's organisation culture, while it was alien to those used to a socialist vision of India.

• Government instigated the creation of critical elements of market infrastructure—NSE, National Securities Clearing Corporation (NSCC), National Securities Depository Limited (NSDL), Clearing Corporation of India Limited (CCIL)—all of which embodied a new governance model with a three-way separation between the owners, the management team and the financial firms which became members and utilised the services. These organisations brought a new concept of highly efficient public utilities into Indian finance.

This process required a torrid pace of legal reform. The erstwhile Securities Contracts (Regulation) Act (SC(R)A) of 1956 and the new SEBI Act of 1992 are the most important documents which made all this possible. This required a sustained effort of steering the text of SC(R)A away from mistakes in the original drafting, and ill-thought out amendments of the intermediate years, towards a modern text. It also required a sustained effort from 1988 to 1992 to get the SEBI Act into place, and then to make numerous modifications to it reflecting a modern vision and the requirements of India of 2009.

The key lessons of the equity market concern fundamental change in the role and functioning of government agencies. The revolution of the equity market was not achieved by respecting existing structures and politely requesting them to catch up with the idea of India as a market economy. The erstwhile Controller of Capital Issues (CCI)

was closed down; a new SEBI was created; acute pain was inflicted on BSE; all regional exchanges other than BSE went extinct in effect; a new governance model was invented and used for the creation of new agencies in the form of NSE, NSCC, NSDL and CCIL.

By and large, the agenda of establishing a world-class equity market has been achieved. Progress has petered out as the implications of these changes have been fully worked out. Achieving further progress requires a new array of legal changes. The path for these has been mapped out by the Percy Mistry, Raghuram Rajan and Jahangir Aziz committees. Three goals stand out:

1. Establishment of the Debt Management Office (DMO), designed by the Jahangir Aziz committee. This will be the investment banker to the government, thus unburdening RBI of the three-way conflict of interest: of setting the short-term

foreign banks against opening branches, and a mechanism through which new private banks can come about. This involves aiming for a dynamic framework where every year, 5-10 new banks come about and 2-5 banks are closed down. As with airlines and telecom, bank privatisation is useful but not essential to obtaining progress: it is possible to obtain enormous progress by merely easing up on the existing entry barriers which uphold the prevailing stasis.

While the Bank Regulation Act (BRA) forced banks to take permission from RBI for the purpose of opening branches, it remains possible for RBI to set up a frictionless process through which approvals are automatically and immediately given, so that in effect, the entry barrier is eliminated. Apart from this, all these other elements of making progress on banking do not require legislation. This emphasises the glaring failure of economic policy in banking, where even though leg-

By and large, the agenda of establishing a world-class equity market has been achieved. Progress has petered out as the implications of these changes have been fully worked out. Achieving further progress requires a new array of legal changes. The path for these has been mapped out by the Percy Mistry, Raghuram Rajan & Jahangir Aziz committees.

interest rate while trying to sell bonds for the government at the lowest possible interest rates and regulating banks which are the prime buyers of government bonds.

2. Unification of the regulation of all organised financial trading at SEBI. This involves merging the Forward Markets Commission, which regulates commodity futures through legislation enacted in 1952, into SEBI. It also involves shifting the work being presently done at RBI (rooted in legislation enacted in 2006) in regulating the currency and bond markets into SEBI. Alongside this, further work is needed on editing the SC(R)A to reflect modern thinking about securities law.

3. Enactment of the PFRDA Bill, which will give legal clarity to the regulation of the New Pension System (NPS).

These three elements are critically about law-making. Each of them represents a major advance in Indian financial sector reforms, and will not be achieved without legislation.

In addition, there is one area where critical progress does not hinge on legislation. This is the removal of entry barriers in banking. This includes removal of restrictions on domestic and

isitative activism is not the critical bottleneck, progress has not been achieved.

The last major achievement in Indian financial sector reforms was in 2001, when the equity market shifted to rolling settlement and derivatives trading came about fully. From 2001 till 2009, there has been little progress on financial sector reforms. There is an increasing gulf between the needs of India as a trillion dollar globally integrated economy, and the ramshackle financial system which is in place. The technical work that is required has been put into place, through the Percy Mistry, Raghuram Rajan and Jahangir Aziz reports. In its second innings, the UPA government must now move on these legislative changes which will unleash a next phase of fundamental change, much like the legislative activism of the 1990s made the revolution of the equity market possible.

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EDUCATION

Lighting Kapil Sibal's path

Optimism and caution on education reform

K SATYANARAYAN

KAPIL SIBAL has brought a breath of fresh air to the debate on education reform. As the minister handling the education portfolio he has set out a 100-day agenda and thrown up many ideas since he took office. What are his prospects for accomplishing meaningful reform within the next 5 years of the electoral cycle? Let us consider the possibilities.

There are two overarching themes of reform on the anvil—drastically expanding supply and regulating for quality. Fortunately for Mr Sibal, there is broad consensus on these being the sine qua non for education reform. The differences of opinion are on the means towards achieving these ends. He needs to keep the focus relentlessly on the ends.

Though Mr Sibal has declared his intention of opening up education to for-profit entities, he will need to build popular support to take on the vested interests as well as the vestiges of old dogma, who are bound to put up strong resistance.

Mr Sibal must set two specific goals in the expansion of supply of education. The first is to educate every one of the around 250 million children who will be in the age group of 5-14 by 2020. The second is to double the Gross Enrolment Ratio in higher education from about 12 today to 25 by 2020. These goals should drive the reform agenda.

The reforms can be boiled down to three specific issues. How do we fund education for all? Who should run the educational institutions? And, how should we regulate all these institutions? Let us look at each of them in turn.

How do we fund education for all?

There have been substantial increases in the state-funding for education over the past decade, with further increases planned over the next five years. Despite that, there is little hope for the state to be able to provide all the funding by itself to achieve our goals by 2020. The state's funding will have to be augmented with substantial private investment from both institutions as well as individuals.

It is necessary to immediately open up education to for-profit organisations to attract private institutional investment. Although education is a *de jure* non-profit activity today, it is more often than not, a *de facto* for-profit activity, with the profits being disguised and illegally siphoned out in most cases by opportunists and fly-by-night operators. Permitting for-profit education will attract substantially large private investments from individuals and organisations who are willing to invest in education with the hope of contribution to national growth and making a fair profit legally. Indeed the profits can be invested right back into education to expand supply further. Non-banking finance companies and mutual funds can launch specific education sector funds to attract investment from the public for investment into educational institutions.

Though Mr Sibal has declared his intention of opening up education to for-profit entities, he will need to build popular support to take on the vested interests as well as the vestiges of old dogma, who are bound to put up strong resistance. It will also require all of his legal acumen to navigate through the Supreme Court judgements on this matter, obtain clarifications from the Court if required, and push through the necessary legislation to make this a reality.

At an individual level, long term loans at interest rates comparable to that for housing loans must be made available to every student to fund higher education. This will help bring in private investment from individuals and their families. These students can pay back the loans from their future earnings and that money can in turn help fund the next set of students.



Photo: Alokemon

Who should run our educational institutions?

The extent of the State's role in the provision of education—operating schools—needs to be debated. In the early decades after independence, when private participation in education was minimal, the State had to force itself to be the provider of education too. The State's ability to be a provider of high quality education has come under question in recent decades. Parents increasingly prefer to pay for private education, despite having access to free education in State schools. Many private schools charge much less per child than what the State spends per child in State-run schools, to provide education that is often perceived by parents as much higher in quality than that provided in the free State-run schools. Given this reality, the State ought to encourage more private provision of education, with State funding. This is already happening in the form of State-aided, but privately run schools and needs to be expanded in a large way.

The idea of State-funded educational voucher programs has received much attention in India amongst policy-makers and law-makers over the past few years. Mr Sibal has already stated that he is open to voucher programs that directly fund the student and we must experiment with voucher programs.

How should education providers be regulated?

While initiating reforms on the supply side, regulatory reform must be initiated in tandem. All schools and higher education institutions, whether state-run or privately run, must be subjected to strict regulation to ensure quality stan-

dards are adhered to. Mr Sibal has already come out in favour of independent and autonomous regulators, with the ability to act without fear or favour. These regulators must be established quickly and given the autonomy to get on with their job.

The Yashpal Committee Report has proposed the setting up of a new body, the National Council of Higher Education and Research, as an umbrella regulator of higher education. It remains to be seen what parts of the Yashpal Committee Report will be accepted and implemented. Mr Sibal has himself proposed a new agency to rate and accredit all schools, including the State-run ones.

The regulator must mandate every institution to publish a report twice a year for the benefit of not just the regulators but also the general public. The report must disclose details of the institution's management, academic staff, infrastructure, resources, financial statements, academic performance, ratings and other relevant data. Transparency and access to detailed information will go a long way in ensuring that the institutions maintain quality standards in.

Mr Sibal's prospects

By publishing his agenda Mr Sibal has thrown open his ideas for debate and critical review. He has also provoked widespread participation in the debate on reform, eliciting feedback from not just those involved in education, but also the larger public as well. His proposal to make the Class X board examinations optional has galvanised public interest in the debate on education reform.

The minister will need to constantly keep en-

gaging with the public, get them on his side and build momentum for the important pieces of reforms, to overcome the resistance from various quarters both within and outside the government and his own party. Fortunately, the Prime Minister is said to be fully backing these initiatives.

The UPA Government will have to convince voters that reforms have led to tangible benefits for them by the time of the next general elections in 2014. But Mr Sibal must refrain from spreading

himself thin. He must focus on three or four key aspects of reform, and no more, and show substantial progress in these areas over the next five years.

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PUBLIC POLICY

A theory of corruption

The regulations that keep industry uncompetitive also cause corruption

AADISHT

THE RELATIONSHIP between business and government in India has usually been one in which interaction happens through bribes or kickbacks, given voluntarily or extorted. At one time, this ugly relationship got a lot of attention. The Bofors scandal helped the National Front government to come to power, and Arun Shourie's muckraking on Reliance's rule-breaking captured the imagination. However, with the rise of identity politics corruption ceased to be the preeminent popular demon.

Corruption has made a quiet return to public consciousness, however. Although the new UPA government is being held to task most over its foreign policy blunder at Sharm-el-Sheikh, its first few months have been marked by a number of controversies related to corruption. Ministers from the DMK, a coalition partner, were accused of holding out for 'ATM ministries', there was a scandal about the auction of seats in colleges, and most recently, Anil Ambani has unleashed a broadside upon the petroleum ministry. What causes all this corruption, and is its scale more or less than what the media suggests? And how important is it really?

Andrei Shleifer and Robert Vishny wrote a landmark paper on government corruption in 1993, in which they pointed out that opportunities for corruption will be created whenever an individual or business is dependent on government to provide a good—this may be an actual good or a right or enablement to conduct business—such as road access, or an import licence, or a business

registration. If the government does not monitor the behaviour of its officials; or if there is no competition between various divisions or agents of the government to provide these goods, corruption becomes more likely.

India has always provided wonderful opportunities for corruption. There are, or used to be, a plethora of regulations—taxation, labour welfare, how much installed capacity a factory could have, and so on. Moreover, each of these are managed by a different government agency, and so businesses have to pay multiple independent bribes. But what sort of bribes are these?

Consider one of India's many small factories. It faces regular inspections by excise inspectors, labour inspectors, fire safety inspectors, and pollution control inspectors. Complying with every item on these inspectors' lists needs expertise and money that it does not possess. So, it bribes the inspector to ensure that the violation is overlooked—until the inspector's next visit.

The inspectors will visit again and again, and collect their bribes. Over time, the business will pay out a steady stream of money to various government officials, which it will try to make up for by giving its customers substandard products, or by cheating its employees of pension contributions, or by blatantly cutting corners on safety or pollution control—after all, the inspector is being paid off anyway.

Now, expand your focus and consider the situation as it applies to every small company in India. They will all be bribing inspectors and cut-



Photo: Wally Gobetz

ting corners on safety or employee welfare purely to remain competitive. Thus, thousands of crores of rupees will flow to inspectors, and thereafter up the bureaucracy to the secretaries and ministers who auction the posts of inspectors.

What makes this interesting is how different it is from corruption in the developed world. There, corruption is replaced by its genteel cousin, lobbying. Businesses in the First World lobby legislators and capture regulators so that the rules are set to

India is filled with a huge number of small companies or individual enterprises in all its sectors—subsistence-sized farms in agriculture, small shops in retail, barely viable manufacturing units, and small time service providers. This industry structure—thousands of pygmies—is a legacy of Indian policy and regulations. These regulations include a small scale industry (SSI) policy that only allowed certain products to be manufactured by small companies—and thus

The domestic market structure provides us an insight into India's corruption. The fact that there are so many small low-quality producers is the reason the endless payments to government inspectors persist. The small enterprises are too small to influence politicians to change the system of regulation and the costs involved in them banding together to influence policy are prohibitive.

their advantage; rather than endlessly pay off inspectors to ignore their violation of the rules.

Seeing this, you might be tempted to ask why Indian businesses do not follow in the footsteps of their Western counterparts and convince legislators to end the regime of inspectors once and for all rather than pay inspectors in perpetuity. After all, there is always the risk that the business will one day run up against an incorruptible or excessively greedy inspector. And if the management is able to turn its attention away from paying off bureaucrats, it can focus on making better products, or keeping its employees happier.

This is being overoptimistic.

prevented their manufacturers from ever growing. Financial policy directed bank credit to the priority sector, which meant that a farmer could get a loan to buy a cow; but a dairy owner could not get a loan to expand his premises. The overall economic environment was not conducive to growth, either—spots in industrial parks were rationed (and tiny if you got one), there was no transport or communication infrastructure, purchasing land was incredibly difficult, and finding employees with the right skill set was difficult.

The politically well connected, and the companies which were already big were always able to get through this. Tarun Khanna and Krishna Pa-

lepu have theorised that the reason that conglomerates were successful in India is that they allowed each subsidiary to access the parents' skill in obtaining licences and dealing with regulations in an economy where they were at a premium, and which was starved of factor inputs like capital and skilled managers.

More unscrupulous promoters would set up joint ventures with state industrial development corporations, saddle them with debt, and decamp with the cash. Large companies which were already manufacturing a product that would get an SSI reservation could get a grandfathering exemption—and so Colgate was gifted years of monopoly power in the Indian toothpaste market.

Research by Subhrajit Guhathakurta showed that the SSI reservation policy led to a market structure where there would be a monopoly or oligopoly of large companies serving the higher end of the market, and a panoply of small manufacturers serving the lower-end of the market with

that inspector to go after a competitor, or in fact your own enterprise if you want to force other shareholders out.

Second, freedom for the whole industry can be dangerous. If all your competitors are cut down to the same level as you by corruption and regulation, everyone makes a little money; but in a free environment, your nimbler and smarter competitors will quickly outstrip you. The risk of extinction by competition balances out the risk of extinction by incorruptible bureaucrat. And building the skills required to win in a free environment is something which is difficult for enterprises that small to do. The result is a business environment where shareholders and inspectors profit at the expense of government, customers, and employees.

India is no stranger to large-scale corruption or bending of rules. Big corruption appears more repugnant, but it is the smaller corruption that is more outrageous. This is because it corrupts the officials who interact directly with the weakest and poorest—police constables, excise inspectors, and electricity board linesmen. Moreover, by making these posts lucrative, it encourages senior officials to auction them, and spreads corruption throughout the bureaucracy. Despite this, petty corruption does not attract attention, except in the occasional forwarded email or vigilante movie.

Policy moves that lead to systemic changes are more likely to work than *Anniyan* or *Dombivili Fast* style vigilantism, though. These can take the following forms:

1. The government uses technology to ensure that its agents do not or can not seek bribes—for example, the computerisation of railway ticket reservation in the 1980s

2. The government removes its right to grant necessary permits, or at least creates competition within its arms to grant these—for example, ending industrial licensing.

3. Most interestingly, a disruption in business models could mean that the game of all competitors bribing inspectors and passing the costs on to their customers or employees is no longer feasible. This could be triggered by one enterprise obtaining funds to invest and change the cost structure of the industry, or by new entrants, or the purchase of new technology. All of these will accelerate in an economic environment in which the markets for capital, corporate control, and technology are freed up.

The last is most visible in the Indian construction and highway building industry. The Golden Quadrilateral project allowed its contractors to be partially foreign-owned, creating a new breed of

Big corruption appears more repugnant, but it is the smaller corruption that is more outrageous because it corrupts the officials who interact directly with the weakest and poorest. By making these posts lucrative, it spreads corruption throughout the bureaucracy.

poor quality products.

India's market structure provides us an insight into India's corruption. The fact that there are so many small low-quality producers is the reason the endless payments to government inspectors persist. The small enterprises are too small to influence politicians to cancel the system of regulation, and so are forced to make the recurring small payments. There are so many of them, that the costs involved in them banding together to influence policy are also prohibitive. And as Messrs Shleifer and Vishny point out, being competitive means you have to be corrupt when everyone else is doing it.

But it is not just a question of the lack of ability to influence policy. The victims of corruption are happy to see it continue.

This is for two reasons. The first is that while there is always the risk of an incorruptible or overzealous inspector shutting down your own enterprise, you also have the option of bribing

contractors who saved money by using capital intensive processes, not by cheating on material quality or specifications. But this disruption in business models will also be caused by reducing government intervention in some other area—FDI limits, financial regulation, or tax and labour laws—which restrict business dynamism.

India has taken baby steps in market liberalisation. Industrial licensing has gone. The number of products reserved for SSI manufacture is down from a peak of 873 in 1984, to 21 today. For a medium enterprise to obtain formal financing is far easier today than it was fifteen years ago. These

steps were not taken to reduce corruption by agents of the state, but have unintentionally accomplished it. Further liberalisation will free not only markets, but also India's many small enterprises from predation by state agents.

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PUBLIC POLICY

Photo: McKay Savage



Competition and commission

Antitrust negates the rule of law

HARSH GUPTA

ONE OF the alleged defects of capitalism is that it creates very large companies with market power, which if not checked by antitrust laws or competition commissions, would soon become an exploitative monopoly. Therefore, in India we had the Monopolies and Restrictive Trade Practices Commission (MRTPC) created in 1969. The MRTPC set arbitrary quantitative limits on a company's growth—for example, companies with

assets more than Rs 1 billion (US\$ 20 million presently) needed government permission to expand or start a new undertaking. In 1991, the most restrictive clauses of the MRTPC were rationalised but the need for "smarter" antitrust was still felt. Now, the Competition Commission of India (CCI) is being staffed, as it supplants the "command and control" MRTPC. The CCI is admittedly better—the biggest improvement is that antitrust of

fences would be evaluated based on industry structure, and not just firm size. Therefore, whether a company's turnover is huge or not now matters less than whether relatively it is a dominant player in its industry, and whether it is abusing its dominance in the eyes of the commission.

But antitrust has a fundamental defect—it is against the very essence of the rule of law. This is because whether an antitrust violation has been committed or not is not decided solely by predetermined objective and quantitative criteria, despite pretensions to the contrary, but ultimately by bureaucrats according to their biases. This is so because anything can be, and is, labelled as anti-competitive—low prices are called predatory pricing, similar prices can be called price fixing, and high prices can be called price gouging! Since obviously all transactions would not be punished, stating any objective criteria which would also not criminalise obviously innocent practices is very difficult to do. The quasi-jurisprudence of antitrust even has a “rule of reason” to decide such

client allocation of scarce resources across time (if petrol pumps are forced to keep the same price when future supply is in question because of, say, a natural disaster, then the stocks would be quickly sold out and no petrol would be on the market—or more likely, it will now be in the underground market). Price-fixing, as mentioned earlier, can actually raise competition in many circumstances. Moreover, there is technically no such thing as a relevant “market” for a specific company. A butter producer might have a 70 percent market share in butter sales, but if the company does try to exploit its market power and raise prices, customers may shift towards margarine. Underestimating the true market choices of butter customers—and forcibly decreasing its price—will hurt the margarine industry, and force customers into a sub-optimal product-price choice.

Michael Sproul, a lecturer at California State University, Northridge, has “little doubt that in the great majority of cases antitrust prosecution does not lead to lower prices. In general, an indictment for price fixing results in slightly higher prices.” Indeed, with the spread of economic globalization, competition cannot be avoided by even the biggest firms—therefore, antitrust reorganisations and litigation do little save enriching lawyers and bankers. In many cases the artificially high market power that still exists is either because because of over-regulation (it is strange why unions are never subjected to antitrust) or trade barriers (which protect the industry against foreign competition). In India, protection can still be observed in products like second-hand cars or professional services like law and finance. As Henry Havemeyer, president of the American Sugar Refining Company, observed more than a century ago that the “tariff is the mother of the trust.”

Even in supposedly blatant “market tying” cases like Microsoft trying to block out competitors of Internet Explorer web browser, what could have been demanded was simply that Microsoft should not block the installation of any other browser on its operation system (OS). But the authorities wanted nothing less than the break up of the company! Yet in just a few years after that antitrust threat, the Schumpeterian reality of “creative destruction” in the marketplace has caught up with Microsoft without any government policing. Apple's OS is eating away Microsoft's share, while Mozilla Firefox and Google Chrome can be easily—and for free—downloaded from the internet.

Therefore, the costs of “market failure” are of-

The Competition Commission of India should be further broken up into units—one part serving as an internal “competition advocacy” think tank, and another serving as a prosecutor and investigator, but not as a judge.

cases, which sounds eerily contradictory to the rule of law.

But a few antitrust cases do not violate the rule of law—for example, obvious price-fixing agreements which are declared *per se* illegal. Yet, even here it is not clear why all price-fixing arrangements are anti-competitive—if the second and third biggest players fix prices to compete with the biggest player in an industry, competition could actually increase. Indeed, this is often the basis of mergers and acquisitions (M&As)—but while price fixing is scorned upon, a complete union is benignly looked at.

Antitrust rarely works. What seems like “unfair practices” to technocrats often turn out to be economies of scale (the bigger the firm, the lower the average cost and in a market with even a few competitors, that means a lower selling price) or economies of scope (buying a car with a built-in audio system may be cheaper and more convenient for the customer). Similarly, price gouging (or “unfairly” high prices) is necessary to ensure effi-

ten exaggerated, but the costs of government failure are underplayed. Antitrust authorities are used by politicians to protect their political friends and to co-opt economic elites through antitrust threats. For example, Paul O' Neill, chief executive officer of Alcoa and later US treasury secretary in the George W Bush administration engineered a global aluminium cartel yet was shielded by US antitrust authorities. But in February 1996 a small-time seller of painted aluminium signs for gasoline stations was arrested for price-fixing. In India too, the Jet-Sahara merger was unnecessarily rocked by MRTPC deliberations—any “abuse of dominance” is only possible if the companies were at least sustainably profitable (which Jet and Sahara were not).

Nevertheless, antitrust can be useful in a strategic sense simply because other countries often hold the antitrust veto on many M&As between Indian firms and their firms. If an EU antitrust action threatened any Indian take-over, a retaliatory threat against European MNCs could be conveyed. Threats should lead to deterrence—because otherwise both economies would unnecessarily suffer. (This situation is very similar to trade policy where unilateral free trade is beneficial by itself but if protectionist threats can induce lowering of barriers in other countries then the benefit is further increased.) Somewhat similarly, antitrust can potentially be creatively used by developing countries like India to wage a rearguard

battle against TRIPS (Trade Related Aspects of Intellectual Property Rights) at WTO to defend medical generics. Also, CCI can also be referred to by the judiciary in various disputes involving substantial natural resources regarding potentially anti-competitive effects—as in the current Reliance Krishna-Godavari Basin controversy.

The CCI should be further broken up into units—one part serving as an “competition advocacy” internal think tank, one part serving as an independent tribunal so that the CCI can serve as a prosecutor and investigator, but not as a judge (so that company privacy can be maintained, and due process is maintained).

That is, the CCI can be used to deter foreign antitrust action, and to create ideas about how to remove the adverse effects of state-granted monopolies. But to empower bureaucrats and politicians to pass judgement on all M&A activities beyond a certain size, all vertical integration efforts, and all marketing and sales promotions is to further increase crony capitalism and corruption in India. Ultimately what checks market power is competition—foreign or domestic—not competition commissions.

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REVIEW

A canonical list of Hindu intolerance

Competitive intolerance is best challenged by protecting individual rights

ROHIT PRADHAN

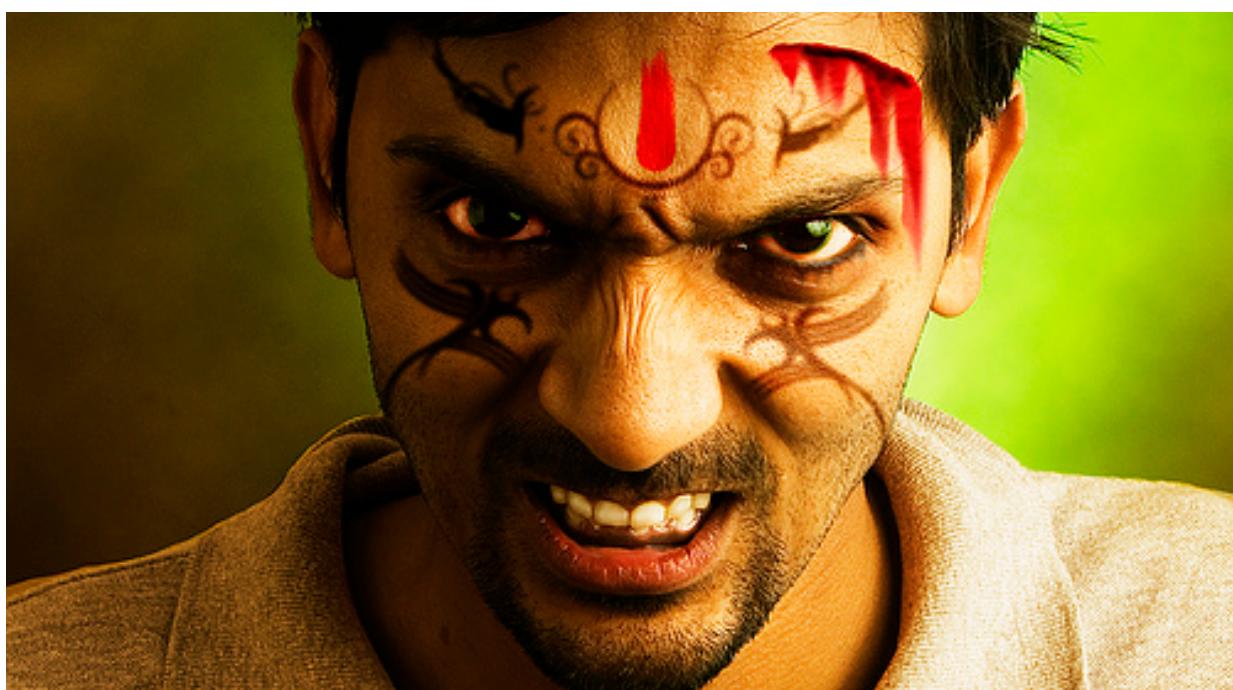
SALIL TRIPATHI'S *Offence: The Hindu Case* is part of the *Manifestos for the 21st Century* series "about faiths, offence, and censorship," which includes similar titles on Judaism, Christianity and Islam. The series aims to defend freedom of speech against religious intolerance and censorship.

For anyone so inclined to review the cases of Hindu intolerance, the book offers an easy reference guide, for it is a comprehensive compilation of all those cases where Hindus—or rather groups who profess to represent them—have taken offence. From the more famous, such as the case of

erant streak has challenged this constitutional right—an essential tenet of a liberal democracy as India professes to be—and the state and the society have more often than not meekly acquiesced and surrendered. In fact, often it is the politicians who are the first to take offence—latest case in the point, the reality show *Sach ka Saamna*, which has parliamentarians up in protest demanding a ban for damaging Indian culture.

Therefore, a book which unapologetically defends free speech and raises its voice against intolerance and bigotry is welcome. Unfortunately,

Photo: Rishi S



MF Husain, the celebrated painter, to the trite—publicity hungry “activists” like Rajan Zed in the United States demanding ban on movies like *Love Guru*—nothing, it seems, is too trivial to have escaped Mr Tripathi's attention.

This is not to argue that the book does not raise an important issue—the right to free speech is a fundamental right guaranteed by the Indian constitution. In the last few decades, a growing intol-

Review

Offence: The Hindu Case

by Salil Tripathi
Seagull Books, 102 pages, 2009

Mr Tripathi's book lacks the intellectual heft needed for a work of this nature and does not go much beyond arguments that writers like him have repeatedly made in op-ed columns.

Mr Tripathi traces the rise of Hindu intolerance to the Shah Bano case and the controversy over banning of Salman Rushdie's *Satanic Verses*, which, he argues, led to a sense of majority re-

sentiment cynically exploited by the Hindu Right for advancing its political goals. Subsequently, it led to the Ayodhya movement which facilitated the BJP's rise as a major force in the Indian polity. This emboldened the Hindu Right which channelled its clout in different ways: from riots in which Muslims were specifically targeted to growing intolerance to what were seen as assaults on Hindu religion by artists, scholars and other intellectuals. Factually, Mr Tripathi's narrative might not be incorrect though it certainly oversimplifies a complex argument. Horrible as Gujarat riots of 2002 were, worse riots had happened in that very state in independent India. They happened much before the rise of BJP as a potent political force. Also, Mr Tripathi does not break fresh ground. These arguments are well known to anyone with even a passing interest in modern Indian history. It also leads us to a more fundamental disagreement with Mr Tripathi's thought process.

Discussing the MF Husain case, accused of hurting Hindu sentiments by painting nude images of Hindu goddesses, Mr Tripathi offers a brief overview of Hindu mythology. He points to famous temples like Khajuraho with their explicit depiction of myriad sexual acts and argues that Hinduism historically celebrated sexuality; the modern puritanical streak is result of transplanted Victorian sensibilities. Again, this is a well-known strategy which essentially attempts to delegitimise conservatives by pointing out that their protests are inconsistent with the religion they profess to protect.

Convenient as this strategy may be, it is also fraught with danger. Arguing in terms of religious sensibilities and acknowledging that outrage against Mr Husain's painting would have been somewhat understandable if Hinduism did not apparently sanction and celebrate similar paintings invariably leads to a slippery slope. Proponents of Hindu religion would no doubt point out, as they have done in the past, that Mr Husain is misinterpreting and deliberately exploiting deeply religious symbolism. More importantly, it raises a fundamental question: What if Hinduism did not have these depictions or what if someone were to paint Muslim figures—should they be prosecuted because they apparently enjoy no religious sanction?

Mr Tripathi's answer would no doubt be unequivocal: No. But by placing his arguments in religious morality rather than constitutional morality, he leaves room for unwinnable religious arguments. To be fair, he does discuss the constitutional weaknesses—Article (19)(1)(a) of the Con-

stitution and Section 295(A) of the Indian Penal Code which allow the state to proscribe "offensive" material—but that discussion is perfunctory. This is not a mere pedantic argument—after all, it is the constitutional weaknesses which have allowed Hindu fundamentalists to file hundreds of cases against Mr Husain, virtually hounding him out of the country. It is the Indian State which has permitted this travesty by arming itself with an arsenal of draconian laws which impinge on free speech. And lest it be forgotten, those laws were incorporated in the Indian constitution not by religious fundamentalists but by founding fathers and their parliamentary successors, encouraged by an overarching and overzealous government.

Jawaharlal Nehru's liberalism in that particular

By placing his arguments in religious morality rather than constitutional morality, Salil Tripathi leaves room for unwinnable religious arguments.

sense was as much a failure as his economic policies. After all, despite the BJP being out of power for the last six years, Mr Husain remains effectively a *persona non grata* in India. There are no easy villains and heroes in this complex narrative as Mr Tripathi seems to suggest. Popular Western definitions of liberals and conservatives find limited traction in the Indian political context.

The book closes by briefly touching on politically surcharged topics like Aryan invasion theory and textbook revisions. This section is one-sided and not particularly relevant to the rest of the narrative. The process of politicisation of Indian history is hardly new and some of the historians who Mr Tripathi approvingly quotes have participated in it as willingly as the ones foisted by the BJP's Murli Manohar Joshi.

In the other books in the *Manifestos* series, Brian Klug looks at Judaism, Irena Maryniak discusses Christianity and Kamila Shamsie examines the Muslim case. Like Mr Tripathi's, authors with names that suggest a particular religious affiliation are tasked with critiquing their own religion. Perhaps, more than anything else, that conveys the weakness of this endeavour.

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